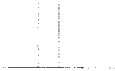


**THE GATT NEGOTIATIONS
AND U.S. TRADE POLICY**

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PREFACE

In September 1986, the member nations of the General Agreement on Tariffs and Trade (GATT) inaugurated a new round of negotiations aimed at further opening the world trading system. The Congress must provide U.S. representatives at these negotiations with negotiating authority and policy direction, and will be asked to ratify the final results when talks end, several years from now. These negotiations come at a time when trade imbalances have become a source of tension in the world economy and when governments are playing a growing and important role in determining the flow of commerce. This report, requested by the Subcommittee on International Trade of the Senate Finance Committee, provides an overview of this round of trade talks and examines how they might affect four sectors of the U.S. economy--high-technology goods, agriculture, mature industries, and services. In keeping with the mandate of the Congressional Budget Office to provide objective analysis, no recommendations are made.

This report was prepared in CBO's Natural Resources and Commerce Division, under the direction of Everett M. Ehrlich and Elliot Schwartz. Stephen Parker made valuable contributions to the content and structure of the report throughout its development. The overview and historical material was written by Stephen Parker and Elliot Schwartz. Chapters on specific sectors were written by Daniel P. Kaplan, Stephen Parker, Elliot Schwartz, and Philip C. Webre. Roger Hitchner, David Trechter, and James G. Vertrees contributed to the chapter on agriculture; Gwyn Adams and Jerrold Abrahams to the chapter on services. Kristen Galles, Peter Glick, Julie Goldman, and Pam Pritchard provided research assistance. Valuable comments were received from Victoria Farrell, Neil Fisher, George Iden, Andrew Horowitz, James Kiefer, and Eileen Manfredi of CBO, and from Robert Baldwin, Thomas Dorsey, Harry Freeman, Robert Hudec, Gary Saxonhouse, Nancy Schwartz, and Lee Tuthill. Helpful suggestions were also made by the Office of the U.S. Special Trade Representative. The report was edited by Francis Pierce, assisted by Nancy H. Brooks, and prepared for publication by Kathryn Quattrone, assisted by Pat Joy.

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CONTENTS

	SUMMARY AND CONCLUSIONS	x
I	INTRODUCTION	1
	What Is At Stake? 2	
	The Negotiating Environment 5	
	The Uruguay Round and the Congress 12	
II	GATT NEGOTIATIONS IN PERSPECTIVE	15
	The General Agreement on Tariffs and Trade 15	
	Previous Rounds: Stage-By-Stage Liberalization 25	
	Looking Ahead: The Uruguay Round Agenda 37	
III	HIGH-TECHNOLOGY TRADE	47
	Current Problems in High-Technology Trade 48	
	Targeting 52	
	Access to Markets 58	
	Intellectual Property Rights 61	
	Bargaining Positions in the Uruguay Round 63	
	Implications of Liberalized Trade 69	
IV	AGRICULTURE	71
	Recent Trends in Agricultural Trade 72	
	National Farm Policies and International Trade 78	
	Bargaining Positions in the Uruguay Round 89	
	Implications of Trade Liberalization For U.S. Agriculture: Two Scenarios 95	

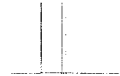


V	MATURE INDUSTRIES: AUTOMOBILES, STEEL, TEXTILES AND APPAREL	99
	Current Problems in Mature-Industry Trade 101	
	Bargaining Positions in the Uruguay Round	112
	Implications of Liberalized Trade	114
VI	TRADE IN SERVICES	119
	Defining Services	120
	Recent Trends in Services Trade	121
	Current Problems in International Services Trade	123
	Bargaining Positions in the Uruguay Round	130
	Implications of Liberalized Trade in Services	132

TABLES

1.	U.S. Tariff Rates, 1789 Through 1984	26
2.	Duty Reductions Since 1934 Under the U.S. Trade Agreements Program	28
3.	Tokyo-Round Tariff Cuts by Stage of Processing for the United States, the European Community, Japan, and Canada	31
4.	Tokyo-Round Tariff Cuts by Industry for the United States, the European Community, and Japan	32
5.	High-Technology Balance of Trade for Selected Years	50
6.	World Market Shares for Wheat and Coarse Grains in Trade Year 1985/1986	75
7.	U.S. Exports and Imports of Agricultural Commodities, 1971-1986	76
8.	U.S. Agricultural Exports by Region, Fiscal Years 1981 and 1986	77
9.	U.S. and EC Outlays for Price and Income Supports	80
10.	Ranking of Producer Subsidy Equivalents by Commodity and Country, 1982-1984	90
11.	Weighted Averages of Producer Subsidy Equivalents by Country, with Major Sources of Assistance, 1982-1984	91
12.	Trade Balances by Products and Countries	100
13.	Net Balance of Trade in Services	122
14.	U.S. Exports and Imports, Selected Years	124





FIGURES

1.	World Agricultural Exports	73
2.	Apparel Industry: Trade Balance of the United States and the European Community with Developing Countries	108
3.	European Community: Steel Production, Consumption, and Capacity	110

BOXES

1.	Reciprocity in GATT Negotiations	7
2.	The U.S. Trade and Budget Deficits	10
3.	The General Agreement in Brief	18

SUMMARY AND CONCLUSIONS

The General Agreement on Tariffs and Trade (GATT) is both a multilateral agreement and an organization that administers the agreement among the 93 signatories. Seven rounds of GATT-sponsored multilateral trade negotiations have progressively lowered postwar tariff barriers, and an eighth round--the "Uruguay Round"--is now taking place.

The Uruguay Round is occurring at a critical juncture in international trade relations. The GATT rules and procedures that have successfully guided four decades of trade liberalization show signs of breaking down. Unless confidence in GATT is renewed, present difficulties could lead to a costly global trade war.

IMPORTANCE OF THE URUGUAY ROUND

Governments are increasingly resorting to policies that are not regulated by GATT, and that conflict with its principles of open and nondiscriminating trade. Such government actions are often felt to be essential to maintaining the competitiveness of national industries. As tensions rise, this tendency may escalate into retaliatory measures and countermeasures. The importance of the Uruguay Round lies not so much in how any one of the items on its agenda is resolved as in the recognition by governments of the need to modernize the GATT framework so as to reflect the increasing importance of international markets, and to accept the resulting changes in their own policies.

Many hope that new GATT agreements will work to reduce the huge U.S. trade deficit. Such a hope is probably misplaced. Most of the aggregate trade deficit can be attributed to divergent macroeconomic policies among the major industrialized countries. In particular, high U.S. government budget deficits have been a major cause of the recent surge in the U.S. trade deficit.

The Uruguay Round requires attention from the Congress for several reasons. Most immediately, the Congress must provide new authority for these negotiations, along with policy direction. In addition, it must consider

the possible effects of the Uruguay Round on federal programs that are sensitive to international trade--most obviously in agriculture. Through their effects on such programs, new trade agreements could ultimately have an impact on the federal budget.

Trade negotiations take time. This round of talks--preliminary negotiations have already begun--is not scheduled to end until 1991, although some interim agreements may be reached before then. After Congressional approval, more time will be required to phase in the new policies. Whatever the outcome of the trade talks, then, most of the direct effects on U.S. policy and economic activity will not occur until well into the 1990s.

The Uruguay Round could nevertheless have an immediate impact on the way governments deal with their trade problems. If the talks were to deadlock, governments might resort to actions outside the realm of GATT to serve their national interests. On the other hand, indications that the talks were moving toward a successful resolution of key problems would lessen pressure for immediate and possibly harmful government actions. In this sense, the talks will succeed in the short run if they foster an atmosphere of cooperation that reduces current tensions among countries.

The main focus of these negotiations, however, will be on the long term. The benefits of open trade are well known: trade expands the range of goods available for consumption and increases productivity by allowing producers to specialize according to their resources and technology. But opening up trade creates problems, such as how to address the unequal distribution of benefits and losses among different groups in a country, and how to react when another country attempts to promote some of its own industries at the expense of its trading partners.

One way of analyzing the Uruguay Round is to examine its possible consequences for particular sectors of the U.S. economy. This report looks at four broad sectors--high-technology goods, agriculture, mature industrial products, and services--to see how they might be affected by trade liberalization.

THE URUGUAY ROUND IN PERSPECTIVE

The Uruguay Round will be judged largely on how well it addresses issues related to nontariff barriers. Examples of nontariff barriers (NTBs) range from direct quantitative controls on imports to the less visible effects of national economic policies on trade flows. GATT has been unable to regu-

late the use of NTBs for a number of reasons: they are inherently less "transparent" in their effects than tariffs, which makes them difficult to evaluate; and they are often linked directly to national policies that are based on domestic rather than international priorities.

The General Agreement on Tariffs and Trade

The GATT was created following the Second World War as one of three international organizations intended to oversee postwar economic relations, the other two being the International Monetary Fund and the World Bank. GATT's members today account for over 80 percent of world trade.

Four key principles underlie the General Agreement:

- o Member countries should work for the steady reduction of trade barriers and the elimination of quotas.
- o Trade policies among member countries should be applied on a nondiscriminatory (most-favored-nation) basis.
- o A tariff concession, once made, cannot be rescinded without compensation to affected countries, and other forms of protection cannot be substituted to circumvent the concession.
- o Trade conflicts should be settled by consultation.

These principles are not inviolate; exceptions to them have always been tolerated. In fact, many of GATT's current problems stem from both old and new evasions of these principles. Examples of current exceptions include:

- o The Multifiber Agreement governing trade in textiles and apparel;
- o Voluntary export restraints, such as the recent U.S. limits on automobile imports from Japan;
- o Escape-clause actions, such as the recent protection given the motorcycle industry;
- o Agricultural import quotas and agricultural subsidies;
- o Barriers to trade in services, and the failure to protect intellectual property rights;



- o Free trade areas, such as the European Community;
- o Preferential treatment for developing countries;
- o Nontariff barriers to trade; and
- o Retaliatory trade actions.

This list of exceptions to GATT's general principles will comprise much of the agenda for the Uruguay round of multilateral trade negotiations. In essence, the agenda aims to strengthen GATT discipline and expand it to cover all trade in goods and services. If successful, most nontariff policies would come within its purview, which would extend to all major trading countries of the world. The primary concern, however, is not so much strengthening the role of GATT as resolving fundamental disagreements among countries over the role of government in economic activities.

IMPLICATIONS OF THE URUGUAY ROUND FOR U.S. GOVERNMENT PROGRAMS

A distinguishing feature of the Uruguay Round is its emphasis on liberalizing trade barriers--especially NTBs--that are integrally linked to national economic policies. Foreign trade can no longer be dealt with apart from other domestic economic policy concerns. Governments often employ trade policies less for commercial ends than to achieve other goals--economic, political, and social. Significant trade liberalization thus means changing these national programs, and for this reason domestic policies will increasingly be the focus of trade negotiations.

The following is an illustrative, but not comprehensive, list of U.S. government policies that are effectively on the Uruguay Round bargaining table:

- o Farm programs (including export subsidies, import quotas, and domestic price and income support programs);
- o Federal support for research and development;
- o Tax policies that favor domestic producers;
- o National security regulations;

- o Trade Adjustment Assistance and the Job Training Partnership Act;
- o Various trade policy procedures (notably, escape-clause actions);
- o Antitrust regulations;
- o Import quotas (or voluntary export restraints) for various manufacturing goods;
- o All import tariffs;
- o Government procurement practices that favor domestic goods;
- o Federal and state regulations governing banks and other financial institutions;
- o Immigration laws;
- o Transportation regulations (including airlines and shipping);
- o Patent and copyright law, and other intellectual property rights laws;
- o Technical standards and health and safety rules;
- o Bilateral economic agreements;
- o Rights of establishment for foreign firms;
- o U.S. economic policies toward developing countries; and
- o U.S. acquiescence to GATT enforcement powers.

The length of this list illustrates the deep ramifications of foreign trade in the U.S. economy. Similarly lengthy lists could be made for most other countries. Although the Uruguay Round is not likely to require substantial changes in all of these programs, those included in the list will increasingly become the focus of future trade policy negotiations. The United States and other countries have already started reforming several of these policies on a unilateral basis in response to internal economic and political pressures.

The following discussion shows the bearing of the trade negotiations on domestic policies in four sectors. ¹/

High-Technology Products

Trade in high-technology products is already covered by the GATT, but numerous disputes have arisen because many governments subsidize production of these goods in an attempt to gain a competitive advantage. An underlying issue is the extent to which governments can, and should, enhance the competitiveness of domestic producers; and how the spillover effects of such policies can be controlled.

Discussions of intellectual property rights will bear directly on high-technology goods. If an agreement can be reached that tightens the penalties against unauthorized use of patents, copyrights, and trademarks, U.S. firms holding those rights--most generally in high-technology industries--should gain.

Trade liberalization should in general benefit most U.S. producers of high-technology products--in aerospace, computers, electronics, pharmaceuticals, and scientific instruments.

Agriculture

Most barriers to trade in agricultural products have been erected to accommodate domestic farm policy programs. In this country, for example, such restraints often serve to protect domestic farm price supports. Many other developed countries use import barriers and export subsidies in much the same way: to stabilize and nurture the domestic farm sector, not to achieve export or import goals. Such trade barriers cannot be significantly reformed without changing the domestic farm policies they serve. The negotiations will focus on the agricultural policies of developed countries, most importantly those in the United States, the European Community, Japan, Canada, and Australia. Although major policy reforms are likely to benefit the economies of all countries, some farmers may be made worse off by reductions in farm support programs, especially over a transition period. Efforts to compensate farmers for losses may be necessary. For each

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1. No attempt is made here to summarize fully the sectoral analyses contained in Chapters III-VI. A short precis appears at the beginning of each of those sectoral chapters.

country, however, the adjustment costs may be lessened if all countries concurrently open their agricultural markets, which should expand world trade and bolster prices, and if agreements are phased in over a long period of time.

Mature Industries

These industries, such as steel, textiles, apparel, and--increasingly--automobiles, have declined in the advanced industrial countries, even as they have grown in some developing countries. They are technically covered by the GATT, but many countries have sought to develop special protective arrangements for them through formal and informal agreements. Abolishing such practices would force governments to confront the consequences of economic change, such as unemployment, and to revise policies that often impede, rather than promote, adjustment. GATT negotiations over subsidies, escape-clause procedures, and the GATT dispute settlement process will be of particular importance for mature industries. Negotiations in these sectors often take on a North-South polarization, since developing countries are rapidly becoming major suppliers of such goods to developed countries.

Agreements that liberalize trade and reduce trade barriers will have a direct impact on those mature industries that are now accorded special protection. The negative effects would be lessened if the liberalization was truly multilateral. The U.S. automobile industry, for example, might benefit from a reduction of European barriers to Japanese autos, since those barriers have diverted Japanese auto exports from Europe to the United States.

Services

An agreement on services trade would bring a new set of national policies under international scrutiny. All countries regulate service activities to some degree--with the added complication that much of this occurs at the state or provincial level. Many of the regulations embody long-standing social values, such as consumer and producer rights, that are generally considered well within the bounds of national sovereignty. But the spillover effects can be stifling to international trade. The United States, in particular, has untapped export growth potential in many kinds of services, particularly those employing large amounts of high-skilled labor (such as construction, telecommunications, financial services, and skilled professional business services). On the other hand, the United States stands to lose from greater imports of lower-skilled, labor-intensive services (in construction, shipping, and personal services).



KEY ISSUES UNDERLYING THE NEGOTIATIONS

The Uruguay Round agenda covers most of the current issues in international trade. But underlying these issues are a number of more subtle questions. How can trade policy be made more transparent? When does a national economic policy become an internationally unacceptable nontariff barrier to foreign trade? To what extent are governments willing to relinquish their sovereignty and shift their national priorities to accommodate international agreements? Should discriminating trade practices of any kind be allowed? If nontariff barriers are to be liberalized, how can this best be done? Would bilateral or multilateral agreements be preferable? When does a developing country graduate to become a full-fledged member of the international trading community?

Need for Policy Transparency

It is difficult to measure the relative benefits and costs of trade reform unless the effects of national policies can be compared for different countries and industrial sectors. This can be done easily for ad valorem tariffs, which apply a tariff rate in percentage terms to the value of a traded good. For nontariff barriers, however, there is no such "transparent" measure of protection. To negotiate the liberalization of nontariff barriers, ad valorem equivalents of their protective impact must be measured in a way that can be consistently compared between countries, types of policies, and economic sectors. Producer subsidy equivalents, which are being employed for this purpose in the agricultural sector, are one such measure. Another way to achieve transparency is to convert nontariff barriers to equivalent ad valorem tariffs. Not only are ad valorem tariffs more transparent than nontariff barriers such as import quotas, but they also have a less distorting effect on economic decision making.

Introducing transparency requirements should favor U.S. interests by providing U.S. negotiators and firms with a much clearer picture of how foreign governments influence trade flows. Trade policy procedures in the United States are relatively open compared with those in other countries. The United States does employ several nontariff barriers to trade, and converting these to tariff equivalents would show the extent to which import quotas often represent high levels of protection. It would lessen the negative impacts of protection on the economy, and if the tariff-equivalent amounts could be collected by the government (either directly or by auctioning quota rights to the highest bidders), the Treasury would gain the quota rents that otherwise accrue to foreign exporters.